

AEL Re Bermuda Ltd.

Financial Statements

Period from December 2, 2021 through December 31, 2021 and the year ended December 31, 2022

(With Report of Independent Auditors Thereon)

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Report of Independent Auditors

The Audit Committee and Board of Directors
AEL Re Bermuda Ltd.

Opinion

We have audited the financial statements of AEL Re Bermuda Ltd. (the Company) which comprise the balance sheets as of December 31, 2022 and 2021, and the related statements of operations and comprehensive income, changes in stockholder's equity and cash flows for the year ended December 31, 2022 and the period from December 2, 2021 (date of inception) to December 31, 2021, and the related notes (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2022 and 2021, and the results of its operations and its cash flows for the year ended December 31, 2022 and the period from December 2, 2021 (date of inception) to December 31, 2021 in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for one year after the date that the financial statements are available to be issued.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one

resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- ▶ Exercise professional judgment and maintain professional skepticism throughout the audit.
- ▶ Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- ▶ Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, no such opinion is expressed.
- ▶ Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- ▶ Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

Ernst & Young LLP

April 13, 2023

AEL Re Bermuda Ltd.

Balance Sheets

(Dollars in thousands, except share and per share data)

| | December 31, | |
|---|---------------------|---------------------|
| | 2022 | 2021 |
| Assets | | |
| Fixed maturity securities, available for sale, at fair value (amortized cost of \$60,058 as of 2022 and \$0 as of 2021; allowance for credit losses of \$0 as of 2022 and 2021) | \$ 58,162 | \$ — |
| Other investments | 7,335 | — |
| Cash and cash equivalents | 13,215 | 180,000 |
| Funds withheld asset | 3,254,668 | 4,222,531 |
| Deferred tax asset | 109,691 | 56 |
| Other assets, at fair value (related party: \$23,382 as of 2022 and \$72,458 as of 2021) | 23,811 | 72,458 |
| Total assets | <u>\$ 3,466,882</u> | <u>\$ 4,475,045</u> |
| Liabilities and Stockholder's Equity | | |
| Liabilities: | | |
| Policy benefit reserves | \$ 3,511,834 | \$ 4,220,065 |
| Notes payable to Parent | 85,654 | 165,000 |
| Reinsurance payable to affiliate | 202,103 | 9,924 |
| Other liabilities (related party: \$26 as of 2022 and \$144 as of 2021) | 26 | 267 |
| Total liabilities | <u>3,799,617</u> | <u>4,395,256</u> |
| Stockholder's equity: | | |
| Common stock, par value \$1 per share, 250,000 shares authorized; issued and outstanding | 250 | 250 |
| Additional paid-in capital | 79,750 | 79,750 |
| Accumulated other comprehensive income | (1,498) | — |
| Retained deficit | (411,237) | (211) |
| Total stockholder's equity | <u>(332,735)</u> | <u>79,789</u> |
| Total liabilities and stockholder's equity | <u>\$ 3,466,882</u> | <u>\$ 4,475,045</u> |

See accompanying notes to financial statements.

AEL Re Bermuda Ltd.
Statements of Operations and Comprehensive Income
(Dollars in thousands)

| | Year Ended December 31, | |
|--|--------------------------------|---|
| | 2022 | 2021 (December 2 to December 31, 2021) |
| Revenues: | | |
| Premiums and other considerations | \$ — | \$ — |
| Annuity product charges | 1,895 | — |
| Net investment income | 157,348 | — |
| Change in fair value of other assets | (73,044) | — |
| Net realized gains on investments | 1 | — |
| Other revenue | 20,139 | — |
| Total revenues | 106,339 | — |
| Benefits and expenses: | | |
| Insurance policy benefits and change in future policy benefits | 66,491 | — |
| Change in fair value of embedded derivatives | 543,229 | — |
| Interest expense on notes payable to Parent | 3,054 | — |
| Other operating costs and expenses | 13,569 | 267 |
| Total benefits and expenses | 626,343 | 267 |
| Income (loss) before income taxes | (520,004) | (267) |
| Income tax benefit | (108,978) | (56) |
| Net loss | (411,026) | (211) |
| Other comprehensive loss | (1,498) | — |
| Comprehensive loss | <u>\$ (412,524)</u> | <u>\$ (211)</u> |

See accompanying notes to financial statements.

AEL Re Bermuda Ltd.

Statements of Changes in Stockholder's Equity

(Dollars in thousands)

| | Common stock | Additional paid-in capital | Accumulated other comprehensive income | Retained deficit | Total stockholder's equity |
|-----------------------------------|-------------------------|---|---|-----------------------------|---|
| Balance at December 2, 2021 | \$ — | \$ — | \$ — | \$ — | \$ — |
| Net loss | — | — | — | (211) | (211) |
| Other comprehensive income (loss) | — | — | — | — | — |
| Issuance of common stock | 250 | 79,750 | — | — | 80,000 |
| Contribution from parent | — | — | — | — | — |
| Balance at December 31, 2021 | 250 | 79,750 | — | (211) | 79,789 |
| Net loss | — | — | — | (411,026) | (411,026) |
| Other comprehensive income (loss) | — | — | (1,498) | — | (1,498) |
| Balance at December 31, 2022 | <u>\$ 250</u> | <u>\$ 79,750</u> | <u>\$ (1,498)</u> | <u>\$ (411,237)</u> | <u>\$ (332,735)</u> |

See accompanying notes to financial statements.

AEL Re Bermuda Ltd.
Statements of Cash Flows
(Dollars in thousands)

| | Year Ended December 31, | |
|---|--------------------------------|---|
| | 2022 | 2021 (December 2 to December 31, 2021) |
| Operating activities: | | |
| Net loss | \$ (411,026) | \$ (211) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Deferred income tax benefit | (109,237) | (56) |
| Change in policy benefit reserves | (708,231) | 4,220,065 |
| Change in funds withheld asset | 967,863 | (4,222,531) |
| Change in reinsurance payables to affiliate | 192,179 | 9,924 |
| Change in other assets | 48,647 | (72,458) |
| Other | (638) | 267 |
| Net cash used in operating activities | (20,443) | (65,000) |
| Investing activities: | | |
| Proceeds from investments sold, called, matured, or repaid: | | |
| Bonds | 1,100 | — |
| Other investments | 4,004 | — |
| Total investment proceeds | 5,104 | — |
| Cost of investments acquired: | | |
| Bonds | (60,760) | — |
| Other investments | (11,340) | — |
| Total cost of investments acquired | (72,100) | — |
| Net cash used in investing activities | (66,996) | — |
| Financing activities: | | |
| Proceeds from issuance of common stock | — | 80,000 |
| Proceeds from (repayment of) notes payable to Parent | (79,346) | 165,000 |
| Net cash provided by (used in) financing activities | (79,346) | 245,000 |
| Increase (decrease) in cash and cash equivalents | (166,785) | 180,000 |
| Cash and cash equivalents at beginning of period | 180,000 | — |
| Cash and cash equivalents at end of year | \$ 13,215 | \$ 180,000 |
| Supplemental disclosures of cash flow information | | |
| Cash paid during the year for: | | |
| Income taxes | \$ — | \$ — |
| Interest expense | 1,932 | — |

See accompanying notes to financial statements.

AEL Re Bermuda Ltd.

Notes to Financial Statements

December 31, 2022

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

AEL Re Bermuda Ltd. ("we", "our" or the "Company"), a Bermuda exempted Company, is a wholly-owned subsidiary of American Equity Investment Life Holding Company (the "Parent" or the "Holding Company"). The Company was incorporated on December 2, 2021 and is a Class C licensed reinsurer. The Company's primary business operation is reinsurance of life and annuity insurance contracts. On December 31, 2021 the Company executed its first agreement to reinsure life and annuity contracts that were issued by American Equity Investment Life Insurance Company ("AEILIC"), which is a subsidiary of the Parent. The Company may execute other similar reinsurance transactions with AEILIC.

Basis of Presentation

We have prepared the financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP").

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are utilized in the calculation of policy benefit reserves, including the fair value of embedded derivatives in fixed index annuity contracts, valuation of the other assets, valuation of funds withheld assets, and valuation allowances on deferred tax assets. A description of each critical estimate is incorporated within the discussion of the related accounting policies which follow. It is reasonably possible that actual experience could differ from the estimates and assumptions utilized.

Summary of Significant Accounting Policies

Investments

Fixed maturity securities (bonds maturing more than one year after issuance) that may be sold prior to maturity are classified as available for sale. Available for sale securities are reported at fair value and unrealized gains and losses, if any, on these securities are included directly in a separate component of stockholders' equity, net of income taxes. Fair values, as reported herein, of fixed maturity securities are based on quoted market prices in active markets when available, or for those fixed maturity securities not actively traded, yield data and other factors relating to instruments or securities with similar characteristics are used. See *Note 2 - Fair Value of Financial Instruments* for more information on the determination of fair value. Premiums and discounts are amortized/accrued using methods which result in a constant yield over the securities' expected lives. Amortization/accrual of premiums and discounts on residential and commercial mortgage backed securities incorporate prepayment assumptions to estimate the securities' expected lives. Interest income is recognized as earned.

Available-for-sale fixed maturity securities are subject to an allowance for credit loss and changes in the allowance are reported in net income as a component of net realized losses on investments. See *Note 4 - Investments* for further discussion of the allowance for credit losses on available-for-sale fixed maturity securities.

Other invested assets include short-term debt securities with maturities of greater than three months but less than twelve months when purchased.

Realized gains and losses on sales of investments are determined on the basis of specific identification based on the trade date.

Policy Benefit Reserves

Policy benefit reserves for fixed index annuities with returns linked to the performance of a specified market index are equal to the sum of the fair value of the embedded derivatives and the host (or guaranteed) component of the contracts. The host value is established at inception of the contract and accreted over the policy's life at a constant rate of interest. Future policy benefit reserves for fixed rate index annuities earning a fixed rate of interest and other deferred annuity products are computed under a retrospective deposit method and represent policy account balances before applicable surrender charges. For the periods ended December 31, 2022 and 2021, interest crediting rates for these products ranged from 1.00% to 3.25%.

Policy benefit reserves includes the impacts of the AEILIC reinsurance agreement where we assumed investment contracts as of December 31, 2022. See *Note 6 - Reinsurance* for further discussion on the reinsurance impacts.

AEL Re Bermuda Ltd.

Notes to Financial Statements

December 31, 2022

Funds Withheld Asset

The funds withheld asset represents a receivable for amounts contractually withheld by AEILIC in accordance with the coinsurance with funds withheld reinsurance agreement with AEILIC. The investments supporting the funds withheld asset primarily consists of fixed maturity securities, mortgage loans on real estate and residential real estate and are legally owned by the ceding company, however, all economic rights and obligations on the investments accrue to the Company.

The fair values of the fixed maturity securities that support the funds withheld asset are generally based on quoted market prices in active markets, when available, or for those fixed maturity securities not actively traded, yield data and other factors relating to instruments or securities with similar characteristics are used. See *Note 2 - Fair Value of Financial Instruments* for more information on the determination of fair value.

The fair values of mortgage loans on real estate are calculated using discounted expected cash flows using competitive market interest rates currently being offered for similar loans. The fair values of impaired mortgage loans on real estate that we have considered to be collateral dependent are based on the fair value of the real estate collateral (based on appraised values) less estimated costs to sell. The inputs utilized to determine fair value of all mortgage loans are unobservable market data (competitive market interest rates); therefore, fair value of mortgage loans falls into Level 3 in the fair value hierarchy.

The fair value of residential real estate investments are initially based on the cost to purchase the properties and subsequently based on a discounted cash flow methodology. The residential real estate investments are leased to renters through operating lease arrangements. Rental income is recognized on a straight-line basis over the term of the respective leases.

Reinsurance agreements written on a funds withheld basis contain embedded derivatives. The right to receive the total return on the assets supporting the funds withheld represent a total return swap. The fair value of the embedded derivative on funds withheld agreements is computed as the unrealized gain (loss) on the underlying assets and will be included in the funds withheld asset on the balance sheet for assumed agreements. The embedded derivative value was \$(652.8) million as of December 31, 2022, compared to zero at the inception of the reinsurance agreement on December 31, 2021.

Other Assets

Other assets includes amounts due from AEILIC representing call options purchased by AEILIC to fund fixed index annuity credits related to the reinsured business. We have elected the fair value option for this asset. We reinsure fixed index annuity products that guarantee the return of principal to the policyholder and credit interest based on a percentage of the gain in a specified market index. When fixed index annuity deposits are received, a portion of the deposit is used by AEILIC to purchase derivatives consisting of call options on the applicable market indices to fund the index credits due to fixed index annuity policyholders. We are entitled to the proceeds on those call options when such call options expire. Substantially all such call options are one year options purchased to match the funding requirements of the underlying policies. On the respective anniversary dates of the index policies, the index used to compute the index credit is reset and AEILIC purchases new call options on our behalf to fund the next index credit. AEILIC manages the cost of these purchases through the terms of the reinsured fixed index annuities, which permit AEILIC to change caps, participation rates, and/or asset fees, subject to guaranteed minimums on each policy's anniversary date. By adjusting caps, participation rates, or asset fees, AEILIC can generally manage option costs except in cases where the contractual features would prevent further modifications. The receivable is recognized in the balance sheet at fair value of the underlying derivatives. Changes in fair value will be recognized immediately in operations.

AEILIC's strategy attempts to mitigate any potential risk of loss due to the nonperformance of the counterparties to these call options through a regular monitoring process which evaluates the program's effectiveness. AEILIC does not purchase call options that would require payment or collateral to another institution and the call options do not contain counterparty credit-risk-related contingent features. AEILIC is exposed to risk of loss in the event of nonperformance by the counterparties and, accordingly, AEILIC purchases our option contracts from multiple counterparties and evaluate the creditworthiness of all counterparties prior to purchase of the contracts. All non-exchange traded options have been purchased from nationally recognized financial institutions with a Standard and Poor's credit rating of A- or higher at the time of purchase and the maximum credit exposure to any single counterparty is subject to concentration limits. AEILIC also has credit support agreements that allows it to request the counterparty to provide collateral when the fair value of the exposure to the counterparty exceeds specified amounts.

Cash and Cash Equivalents

We consider all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

AEL Re Bermuda Ltd.

Notes to Financial Statements

December 31, 2022

Deferred Income Taxes

Deferred income tax assets or liabilities are computed based on the temporary differences between the financial statement and income tax bases of assets and liabilities using the enacted marginal tax rate. The effect on deferred income tax assets and liabilities resulting from a change in the enacted marginal tax rate is recognized in income in the period that includes the enactment date. Deferred income tax expenses or benefits are based on the changes in the asset or liability from period to period. Deferred income tax assets are subject to ongoing evaluation of whether such assets will more likely than not be realized. The realization of deferred income tax assets primarily depends on generating future taxable income during the periods in which temporary differences become deductible. Deferred income tax assets are reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. In making such a determination, all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations, is considered. The realization of deferred income tax assets related to unrealized losses on available-for-sale fixed maturity securities is also based upon our intent and ability to hold those securities for a period of time sufficient to allow for a recovery in fair value and not realize the unrealized loss. See *Note 7 - Income Taxes* for more information on deferred income taxes.

The Company along with its affiliates are included in American Equity Investment Life Holding company's U.S. consolidated income tax return. The Company has made the Internal Revenue Code section 953(d) election to be taxed as a U.S. domestic corporation for purposes of U.S. corporate tax.

Recognition of Premium Revenues and Costs

Revenues for assumed annuity products include surrender charges assessed against policyholder account balances in future periods. Interest sensitive and index product benefits related to annuity products include interest credited or index credits to policyholder account balances pursuant to accounting by insurance companies for certain long-duration contracts. The change in fair value of the embedded derivatives for fixed index annuities equals the change in the difference between policy benefit reserves for fixed index annuities computed under the derivative accounting standard and the long-duration contracts accounting standard at each balance sheet date. There were \$1.9 million of surrender charges recognized during 2022. There were no such charges recognized during 2021.

Other Comprehensive Loss

Other comprehensive loss includes all changes in stockholders' equity during a period except those resulting from investments by and distributions to stockholders. Other comprehensive loss excludes net realized investment gains (losses) included in net income which merely represents transfers from unrealized to realized gains and losses.

New Accounting Pronouncements

In August 2018, the Financial Accounting Standards Board ("FASB") issued an Accounting Standards Update ("ASU") that revises certain aspects of the measurement models and disclosure requirements for long duration insurance and investment contracts. The FASB's objective in issuing this ASU is to improve, simplify, and enhance the accounting for long-duration contracts. The revisions include updating cash flow assumptions in the calculation of the liability for traditional life products, introducing the term 'market risk benefit' ("MRB") and requiring all contract features meeting the definition of an MRB to be measured at fair value and simplifying the method used to amortize deferred policy acquisition costs and deferred sales inducements to a constant basis over the expected term of the related contracts rather than based on actual and estimated gross profits and enhancing disclosure requirements. The ASU is effective for the Company on January 1, 2025. Early adoption of this ASU is permitted. We are in the process of evaluating the impact this guidance will have on our financial statements.

AEL Re Bermuda Ltd.

Notes to Financial Statements

December 31, 2022

2. Fair Values of Financial Instruments

The following sets forth a comparison of the carrying amounts and fair values of our financial instruments:

| | 2022 | | 2021 | |
|---|------------------------|------------|-----------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| | (Dollars in thousands) | | | |
| Assets | | | | |
| Fixed maturity securities, available for sale | \$ 58,162 | \$ 58,162 | \$ — | \$ — |
| Other assets | 23,382 | 23,382 | 72,458 | 72,458 |
| Other investments | 7,355 | 7,355 | — | — |
| Cash and cash equivalents | 13,215 | 13,215 | 180,000 | 180,000 |
| Funds withheld asset | 3,254,668 | 3,254,668 | 4,222,531 | 4,222,531 |
| | | | | |
| Liabilities | | | | |
| Policy benefit reserves | 3,354,545 | 3,262,281 | 4,043,205 | 3,785,390 |
| Notes payable to Parent | 85,654 | 85,654 | 165,000 | 165,000 |

Fair value is the price that would be received to sell an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. The objective of a fair value measurement is to determine that price for each financial instrument at each measurement date. We meet this objective using various methods of valuation that include market, income and cost approaches.

We categorize our financial instruments into three levels of fair value hierarchy based on the priority of inputs used in determining fair value. The hierarchy defines the highest priority inputs (Level 1) as quoted prices in active markets for identical assets or liabilities. The lowest priority inputs (Level 3) are our own assumptions about what a market participant would use in determining fair value such as estimated future cash flows. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, a financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument. We categorize financial assets and liabilities recorded at fair value in the balance sheets as follows:

- Level 1 - Quoted prices are available in active markets for identical financial instruments as of the reporting date. We do not adjust the quoted price for these financial instruments, even in situations where we hold a large position and a sale could reasonably impact the quoted price.
- Level 2 - Quoted prices in active markets for similar financial instruments, quoted prices for identical or similar financial instruments in markets that are not active; and models and other valuation methodologies using inputs other than quoted prices that are observable.
- Level 3 - Models and other valuation methodologies using significant inputs that are unobservable for financial instruments and include situations where there is little, if any, market activity for the financial instrument. The inputs into the determination of fair value require significant management judgment or estimation. Financial instruments that are included in Level 3 are securities for which no market activity or data exists and for which we used discounted expected future cash flows with our own assumptions about what a market participant would use in determining fair value.

Transfers of securities among the levels occur at times and depend on the type of inputs used to determine fair value of each security.

AEL Re Bermuda Ltd.

Notes to Financial Statements

December 31, 2022

Our assets and liabilities which are measured at fair value on a recurring basis as of December 31, 2022 and 2021 are presented below based on the fair value hierarchy levels:

| | Total Fair Value | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|--|-----------------------------|--|--|--|
| (Dollars in thousands) | | | | |
| December 31, 2022 | | | | |
| Assets | | | | |
| Fixed maturity securities, available for sale: | | | | |
| Corporate securities | \$ 43,138 | \$ — | \$ 43,138 | \$ — |
| Residential mortgage backed securities | 1,760 | — | 1,760 | — |
| Commercial mortgage backed securities | 4,650 | — | 4,650 | — |
| Other asset backed securities | 8,614 | — | 8,614 | — |
| Other investments | 7,335 | — | 7,335 | — |
| Other assets | 23,382 | — | 23,382 | — |
| Cash and cash equivalents | 13,215 | 13,215 | — | — |
| Funds withheld asset (1) | 3,220,995 | 234,122 | 2,586,568 | 400,305 |
| | <u>\$ 3,323,089</u> | <u>\$ 247,337</u> | <u>\$ 2,675,447</u> | <u>\$ 400,305</u> |
| Liabilities | | | | |
| Fixed index annuities - embedded derivatives | <u>\$ 442,993</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 442,993</u> |
| December 31, 2021 | | | | |
| Assets | | | | |
| Other assets | \$ 72,458 | \$ — | \$ 72,458 | \$ — |
| Cash and cash equivalents | 180,000 | 180,000 | — | — |
| Funds withheld asset (1) | 4,187,285 | 75,451 | 4,111,834 | — |
| | <u>\$ 4,439,743</u> | <u>\$ 255,451</u> | <u>\$ 4,184,292</u> | <u>\$ —</u> |
| Liabilities | | | | |
| Fixed index annuities - embedded derivatives | <u>\$ 651,146</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 651,146</u> |

(1) Excludes accrued interest income of \$33,673 and 35,246 as of December 31, 2022 and 2021, respectively.

The following methods and assumptions were used in estimating the fair values of financial instruments during the period presented in these financial statements.

Fixed maturity securities

The fair values of fixed maturity securities in an active and orderly market are determined by utilizing independent pricing services. The independent pricing services incorporate a variety of observable market data in their valuation techniques, including:

- reported trading prices,
- benchmark yields,
- broker-dealer quotes,
- benchmark securities,
- bids and offers,
- credit ratings,
- relative credit information, and
- other reference data.

The independent pricing services also take into account perceived market movements and sector news, as well as a security's terms and conditions, including any features specific to that issue that may influence risk and marketability. Depending on the security, the priority of the use of observable market inputs may change as some observable market inputs may not be relevant or additional inputs may be necessary.

AEL Re Bermuda Ltd.

Notes to Financial Statements

December 31, 2022

The independent pricing services provide quoted market prices when available. Quoted prices are not always available due to market inactivity. When quoted market prices are not available, the third parties use yield data and other factors relating to instruments or securities with similar characteristics to determine fair value for securities that are not actively traded. We generally obtain one value from our primary external pricing service. In situations where a price is not available from this service, we may obtain quotes or prices from additional parties as needed. Market indices of similar rated asset class spreads are considered for valuations and broker indications of similar securities are compared. Inputs used by the broker include market information, such as yield data and other factors relating to instruments or securities with similar characteristics. Valuations and quotes obtained from third party commercial pricing services are non-binding and do not represent quotes on which one may execute the disposition of the assets.

We validate external valuations at least quarterly through a combination of procedures that include the evaluation of methodologies used by the pricing services, comparison of the prices to a secondary pricing source, analytical reviews and performance analysis of the prices against trends, and maintenance of a securities watch list. Additionally, as needed we utilize discounted cash flow models or perform independent valuations on a case-by-case basis using inputs and assumptions similar to those used by the pricing services. Although we do identify differences from time to time as a result of these validation procedures, we did not make any significant adjustments as of December 31, 2022.

Fixed maturity security valuations that include at least one significant unobservable input are reflected in Level 3 in the fair value hierarchy and can include fixed maturity securities across all asset classes. We did not have any Level 3 fixed maturity securities as of December 31, 2022.

Funds withheld asset

The funds withheld asset represents a receivable for assets contractually withheld by the ceding company. The funds withheld asset is valued at fair market value. The assets included in the funds withheld asset primarily consist of cash and cash equivalents, fixed maturity securities, mortgage loans on real estate, residential real estate and the accrued investment income on the fixed maturity securities and cash and cash equivalents. The cash and cash equivalents are reported at historical cost which approximates fair value due to the nature of the assets. Accrued investment income is calculated based upon contractual terms which approximates the fair value. Refer to the Fixed maturity securities section above for further discussion of the valuation of the fixed maturity securities included in the funds withheld asset.

The fair values of mortgage loans on real estate are calculated using discounted expected cash flows using competitive market interest rates currently being offered for similar loans. The fair values of impaired mortgage loans on real estate that we have considered to be collateral dependent are based on the fair value of the real estate collateral (based on appraised values) less estimated costs to sell. The inputs utilized to determine fair value of all mortgage loans are unobservable market data; therefore, fair value of mortgage loans falls into Level 3 in the fair value hierarchy. The significant inputs into the fair value calculation include the prepayment speeds, discount rates, and default rates. At December 31, 2022, the average discount rate used in the residential mortgage loans on real estate fair value calculations was 7.06%. At December 31, 2022, the average default rate used in the residential mortgage loans on real estate fair value calculation was 6.00%.

The fair values of residential real estate investments are initially calculated based on the cost to purchase the properties and subsequently calculated based on a discounted cash flow methodology. Under the discounted cash flow method, net operating income is forecasted assuming a 10-year hold period commencing as of the valuation date. An additional year is forecasted in order to determine the residual sale price at the end of the hold period, using a residual (terminal) capitalization rate. The significant inputs into the fair value calculation under the discounted cash flow method include the residual capitalization rate and discount rate. These inputs are unobservable market data; therefore, fair value of residential real estate investments falls into Level 3 in the fair value hierarchy. At December 31, 2022, the residual capitalization rates used in the fair value calculations ranged from 4.75% to 6.50% with an average rate of 5.44%. At December 31, 2022, the discount rates used in the fair value calculations ranged from 6.00% to 8.00% with an average rate of 6.91%.

The coinsurance with funds withheld reinsurance agreement gives rise to an embedded derivative which is bifurcated from the host contract and carried at fair value within the funds withheld asset on the balance sheet. The fair value of the embedded derivative on the funds withheld asset is based on the unrealized gain (loss) on the underlying assets included within the funds withheld account.

Other assets

The fair value of the other assets represents the fair value of call options allocated to the Company from AEILIC. We elected the fair value option due to the nature of the financial instrument. The valuation is based upon the amount of cash that we would receive to settle the derivative instrument on the reporting date. These amounts are determined using industry accepted valuation models and are adjusted for the nonperformance risk of each counterparty net of any collateral held. Inputs include market volatility and risk free interest rates and are used in income valuation techniques in arriving at a fair value for each option contract. The nonperformance risk for each counterparty is based upon its credit default swap rate. We have no performance obligations related to the call options purchased by AEILIC to fund the assumed fixed index annuity policy liabilities. Changes in the fair value of the asset are included in the change in fair value of other assets on the statement of operations and comprehensive income.

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Cash and cash equivalents

Amounts reported in the balance sheets for these instruments are reported at their historical cost which approximates fair value due to the nature of the assets assigned to this category.

Policy benefit reserves

The fair values of the liabilities under contracts not involving significant mortality or morbidity risks (deferred annuities), are stated at the cost we would incur to extinguish the liability (i.e., the cash surrender value) as these contracts are generally issued without an annuitization date. Policy benefit reserves for fixed rate deferred annuities are not measured at fair value on a recurring basis. All of the fair values presented within this category fall within Level 3 of the fair value hierarchy as most of the inputs are unobservable market data.

Notes payable to Parent

The carrying value of our note payable to affiliate approximates fair value as the interest rate is reset on a daily basis utilizing the SOFR adjusted for a credit spread. The note payable to affiliate is categorized as Level 2 within the fair value hierarchy. Notes payable are not remeasured at fair value on a recurring basis.

Fixed index annuities - embedded derivatives

We estimate the fair value of the embedded derivative component of our fixed index annuity policy benefit reserves at each valuation date by (i) projecting policy contract values and minimum guaranteed contract values over the expected lives of the contracts and (ii) discounting the excess of the projected contract value amounts at the applicable risk free interest rates adjusted for our nonperformance risk related to those liabilities. The projections of policy contract values are based on our best estimate assumptions for future policy growth and future policy decrements. Our best estimate assumptions for future policy growth include assumptions for the expected index credit on the next policy anniversary date which are derived from the fair values of the underlying call options purchased to fund such index credits and the expected costs of annual call options we will purchase in the future to fund index credits beyond the next policy anniversary. The projections of minimum guaranteed contract values include the same best estimate assumptions for policy decrements as were used to project policy contract values.

Within this determination we have the following significant unobservable inputs: 1) the expected cost of annual call options we will purchase in the future to fund index credits beyond the next policy anniversary and 2) our best estimates for future policy decrements, primarily lapse, partial withdrawal and mortality rates.

The following summarizes the the unobservable inputs for the embedded derivatives of fixed indexed annuities:

| Unobservable Input | Weighted Average | | Impact of an increase in the input on fair value |
|------------------------------------|-------------------------|----------------------|---|
| | Duration 16 - 20 | Duration 20 + | |
| Cost of future annual call options | 2.4% | 2.4% | Increase |
| Lapse Rate | 8.30% | 4.50% | Decrease |
| Partial Withdrawal Rates | 3.00% | 1.80% | Decrease |
| Mortality | 3.90% | 5.20% | Decrease |

The expected cost of annual call options is based on estimated long-term account value growth and a historical review of our actual option costs. Our best estimate assumptions for lapse, partial withdrawal and mortality rates are based on our actual experience and our outlook as to future expectations for such assumptions. These assumptions are reviewed on a quarterly basis and are updated as our experience develops and/or as future expectations change.

Lapse rates are generally expected to increase as surrender charge percentages decrease for policies without a lifetime income benefit rider. Lapse expectations reflect a significant increase in the year in which the surrender charge period on a contract ends.

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The following table provides a reconciliation of the beginning and ending balances for our Level 3 liabilities, which are measured at fair value on a recurring basis using significant unobservable inputs for the period ended December 31, 2022 and 2021:

| | Year Ended December 31, | Period Ended December 31, |
|---|-------------------------|---------------------------|
| | 2022 | 2021 |
| | (Dollars in thousands) | |
| Fixed index annuities - embedded derivatives | | |
| Beginning balance | \$ 651,146 | \$ — |
| Premiums less benefits | (68,415) | — |
| Change in fair value, net | (139,738) | — |
| Reserve assumed related to in-force reinsurance | — | 651,146 |
| Ending balance | \$ 442,993 | \$ 651,146 |
| Funds withheld asset | | |
| Beginning balance | \$ — | \$ — |
| Purchases and sales, net | 400,305 | — |
| Change in fair value | — | — |
| Ending balance | \$ 400,305 | \$ — |

The change in fair value of the embedded derivatives will be included in Change in fair value of embedded derivatives within the statement of operations.

Certain derivatives embedded in our fixed index annuity contracts are our most significant financial instrument measured at fair value that are categorized as Level 3 in the fair value hierarchy. The contractual obligations for future annual index credits within our fixed index annuity contracts are treated as a "series of embedded derivatives" over the expected life of the applicable contracts. We estimate the fair value of these embedded derivatives at each valuation date by the method described above under **fixed index annuities - embedded derivatives**. The projections of minimum guaranteed contract values include the same best estimate assumptions for policy decrements as were used to project policy contract values.

The most sensitive assumption in determining policy liabilities for fixed index annuities is the rates used to discount the excess projected contract values. As indicated above, the discount rate reflects our nonperformance risk. If the discount rates used to discount the excess projected contract values at December 31, 2022 and 2021, were to increase, the fair value of the embedded derivatives would decrease.

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3. Funds Withheld Asset

The funds withheld asset represents a receivable for amounts contractually withheld by the ceding company in accordance with the coinsurance with funds withheld reinsurance agreement in which we are the reinsurer. Generally, assets at U.S. statutory carrying value equal to U.S. statutory reserves are withheld and legally owned by the ceding company.

At December 31, 2022 and 2021, the following summarizes the underlying investment composition of the funds withheld asset.

| | December 31, | |
|--|------------------------------|------------------------------|
| | 2022 | 2021 |
| | Carried at Fair Value | Carried at Fair Value |
| Bonds: | | |
| States, municipalities and territories | \$ 409,786 | \$ 423,190 |
| Foreign corporate securities and foreign governments | 22,760 | — |
| Corporate securities | 1,332,284 | 2,768,834 |
| Residential mortgage backed securities | 5,392 | — |
| Commercial mortgage backed securities | 188,718 | 338,076 |
| Other asset backed securities | 626,638 | 581,734 |
| Total bonds | 2,585,578 | 4,111,834 |
| Mortgage loans on real estate: | | |
| Commercial mortgage loans | 18,185 | — |
| Residential mortgage loans | 337,349 | — |
| Agricultural mortgage loans | 9,948 | — |
| Total mortgage loans on real estate | 365,482 | — |
| Cash and cash equivalents | 233,365 | 75,451 |
| Accrued investment income | 33,673 | 35,246 |
| Residential real estate | 27,638 | — |
| Other investments | 8,932 | — |
| | \$ 3,254,668 | \$ 4,222,531 |

All of the assets in the funds withheld account were rated investment grade as of December 31, 2022 and 2021. A summary of our funds withheld asset by Nationally Recognized Statistical Rating Organizations ("NRSRO") ratings is as follows:

| Rating Agency Rating | December 31, | | December 31, | |
|-----------------------------|-------------------------------|--|---------------------|--|
| | 2022 | | 2021 | |
| | Fair Value | Percent of Funds Withheld Asset | Fair Value | Percent of Funds Withheld Asset |
| | (Dollars in thousands) | | | |
| Aaa/Aa/A | \$ 1,782,953 | 69.0 % | \$ 2,716,493 | 64.9 % |
| Baa | 802,625 | 31.0 % | 1,470,792 | 35.1 % |
| Total investment grade | \$ 2,585,578 | 100.0 % | \$ 4,187,285 | 100.0 % |

Concentrations of Financial and Capital Markets Risk

The company is exposed to financial and capital market risk, including changes in interest rates and credit spreads which could have an adverse effect on the Company's financial options, results of operations, and liquidity. A rise in interest rates, in the absence of other countervailing changes, will have an adverse impact on the recorded fair value of the Company's fund withheld asset. If long term interest rates rise dramatically within a short period of time, certain of the Company's reinsured products may be exposed to disintermediation risk. Disintermediation risk refers to the risk that policyholders may surrender their contracts in a rising interest rate environment, requiring the Company to liquidate assets earlier than expected. This risk is mitigated to some extent by surrender charge protection provided by the products reinsured by the Company.

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4. Investments

At December 31, 2022 the amortized cost and fair value of fixed maturity securities were as follows:

| | Amortized Cost (1) | Gross Unrealized Gains | Gross Unrealized Losses (2) | Allowance for Credit Losses | Fair Value |
|--|------------------------|------------------------------|-----------------------------------|--------------------------------|------------|
| | (Dollars in thousands) | | | | |
| December 31, 2022 | | | | | |
| Fixed maturity securities, available for sale: | | | | | |
| Corporate securities | \$ 44,051 | \$ — | \$ (913) | \$ — | \$ 43,138 |
| Residential mortgage backed securities | 1,963 | — | (203) | — | 1,760 |
| Commercial mortgage backed securities | 4,766 | — | (116) | — | 4,650 |
| Other asset backed securities | 9,278 | 82 | (746) | — | 8,614 |
| | \$ 60,058 | \$ 82 | \$ (1,978) | \$ — | \$ 58,162 |

- (1) Amortized cost excludes accrued interest receivable of \$429 as of December 31, 2022. Accrued interest receivable is included in the Other assets on the Balance Sheets.
- (2) Gross unrealized losses are net of allowance for credit losses.

There were no fixed maturity securities as of December 31, 2021.

The amortized cost and fair value of fixed maturity securities at December 31, 2022, by contractual maturity are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. All of our mortgage and other asset backed securities provide for periodic payments throughout their lives and are shown below as separate lines.

| | <u>Available for sale</u> | |
|--|---------------------------|-------------------|
| | <u>Amortized Cost</u> | <u>Fair Value</u> |
| | (Dollars in thousands) | |
| Due in one year or less | \$ 12,987 | \$ 12,830 |
| Due after one year through five years | 30,501 | 29,810 |
| Due after five years through ten years | 563 | 498 |
| Due after ten years through twenty years | — | — |
| Due after twenty years | — | — |
| | <u>44,051</u> | <u>43,138</u> |
| Residential mortgage backed securities | 1,963 | 1,760 |
| Commercial mortgage backed securities | 4,766 | 4,650 |
| Other asset backed securities | 9,278 | 8,614 |
| | <u>\$ 60,058</u> | <u>\$ 58,162</u> |

Net unrealized losses on available for sale fixed maturity securities reported as a separate component of stockholders' equity were comprised of the following:

| | <u>December 31,</u> | |
|--|------------------------|-------------|
| | <u>2022</u> | <u>2021</u> |
| | (Dollars in thousands) | |
| Net unrealized losses on available for sale fixed maturity securities | \$ (1,896) | \$ — |
| Deferred income tax expense | 398 | — |
| Net unrealized losses reported as accumulated other comprehensive loss | <u>\$ (1,498)</u> | <u>\$ —</u> |

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96% of the available for sale fixed maturity securities were rated investment grade as of December 31, 2022. A summary of our available for sale mixed maturity securities set by Nationally Recognized Statistical Rating Organizations ("NRSRO") ratings is as follows:

| Rating Agency Rating | December 31, 2022 | | | December 31, 2021 | | |
|--|----------------------|------------------|--------------------------------------|----------------------|-------------|--------------------------------------|
| | Amortized Cost | Fair Value | Percent of Fixed Maturity Securities | Amortized Cost | Fair Value | Percent of Fixed Maturity Securities |
| (Dollars in thousands) | | | | | | |
| Fixed maturity securities, available for sale: | | | | | | |
| Aaa/Aa/A | \$ 44,914 | \$ 43,246 | 74.0 % | \$ — | \$ — | — % |
| Baa | 12,965 | 12,657 | 22.0 % | — | — | — % |
| Ba | 2,179 | 2,259 | 4.0 % | — | — | — % |
| Total | <u>\$ 60,058</u> | <u>\$ 58,162</u> | <u>100.0 %</u> | <u>\$ —</u> | <u>\$ —</u> | <u>— %</u> |

The following table shows our investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities (consisting of 117 securities) have been in a continuous unrealized loss position, at December 31, 2022:

| | Less than 12 months | | 12 months or more | | Total | |
|--|---------------------|-------------------|-------------------|-------------------|------------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| (Dollars in thousands) | | | | | | |
| December 31, 2022 | | | | | | |
| Fixed maturity securities, available for sale: | | | | | | |
| Corporate securities | \$ 43,138 | \$ (913) | \$ — | \$ — | \$ 43,138 | \$ (913) |
| Residential mortgage backed securities | 1,760 | (203) | — | — | 1,760 | (203) |
| Commercial mortgage backed securities | 4,650 | (116) | — | — | 4,650 | (116) |
| Other asset backed securities | 4,631 | (746) | — | — | 4,631 | (746) |
| | <u>\$ 54,179</u> | <u>\$ (1,978)</u> | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 54,179</u> | <u>\$ (1,978)</u> |

The unrealized losses at December 31, 2022 are principally related to the timing of the purchases of certain securities, which carry less yield than those available at December 31, 2022. Approximately 100% of the unrealized losses on fixed maturity securities shown in the above table for December 31, 2022 are on securities that are rated investment grade, defined as being the highest two U.S. National Association of Insurance Commissions (NAIC) designations.

We expect to recover our amortized cost on all securities except for those securities on which we recognized an allowance for credit loss. In addition, because we did not have the intent to sell fixed maturity securities with unrealized losses and it was not more likely than not that we would be required to sell these securities prior to recovery of the amortized cost, which may be maturity, we did not write down these investments to fair value through the statements of operations.

Changes in net unrealized gains/losses on investments for the years ended December 31, 2022 and 2021 are as follows:

| | Year Ended December 31, | |
|--|-------------------------|-------------|
| | 2022 | 2021 |
| (Dollars in thousands) | | |
| Fixed maturity securities available for sale carried at fair value | \$ (1,896) | \$ — |
| Adjustment for effect on other balance sheet accounts: deferred income tax asset/liability | 398 | — |
| Change in net unrealized gains/losses on investments carried at fair value | <u>\$ (1,498)</u> | <u>\$ —</u> |

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Components of net investment income are as follows:

| | Year Ended December 31, | |
|---------------------------|--------------------------------|-------------|
| | 2022 | 2021 |
| | (Dollars in thousands) | |
| Fixed maturity securities | \$ 1,220 | \$ — |
| Cash and cash equivalents | 415 | — |
| Other investments | 284 | — |
| Funds withheld assets | 163,607 | — |
| | <u>165,526</u> | <u>—</u> |
| Less: investment expenses | (8,178) | — |
| Net investment income | <u>\$ 157,348</u> | <u>\$ —</u> |

Proceeds from sales of available for sale fixed maturity securities for the years ended December 31, 2022 and 2021 were \$1,100 and \$0, respectively. Scheduled principal repayments, calls and tenders for available for sale fixed maturity securities for the years ended December 31, 2022 and 2021 were \$0 and \$0, respectively.

Gross realized gains on available for sale fixed maturity securities were \$0 and \$0 for the years ended December 31, 2022 and 2021, respectively. Gross realized losses on available for sale fixed maturity securities were \$1 and \$0 for the years ended December 31, 2022 and 2021, respectively. Credit losses on available for sale fixed maturity securities were \$0 for the years ended December 31, 2022 and 2021. In addition, the allowance on available for sale fixed maturity securities was \$0 as of December 31, 2022 and 2021, respectively.

Realized losses on available for sale fixed maturity securities in 2022 were realized primarily due to strategies to reposition the fixed maturity security portfolio that result in improved net investment income, credit risk or duration profiles as they pertain to our asset liability management. Realized gains and losses on sales are determined on the basis of specific identification of investments based on the trade date.

There were no investments that have been non-income producing for 12 consecutive months as of December 31, 2022 and 2021.

We review and analyze all investments on an ongoing basis for changes in market interest rates and credit deterioration. This review process includes analyzing our ability to recover the amortized cost basis of each investment that has a fair value that is materially lower than its amortized cost and requires a high degree of management judgment and involves uncertainty. The evaluation of securities for credit loss is a quantitative and qualitative process, which is subject to risks and uncertainties.

We have a policy and process to identify securities that could potentially have credit loss. This process involves monitoring market events and other items that could impact issuers. The evaluation includes but is not limited to such factors as:

- the extent to which the fair value has been less than amortized cost or cost;
- whether the issuer is current on all payments and all contractual payments have been made as agreed;
- the remaining payment terms and the financial condition and near-term prospects of the issuer;
- the lack of ability to refinance due to liquidity problems in the credit market;
- the fair value of any underlying collateral;
- the existence of any credit protection available;
- our intent to sell and whether it is more likely than not we would be required to sell prior to recovery for debt securities;
- consideration of rating agency actions; and
- changes in estimated cash flows of mortgage and asset backed securities.

We determine whether an allowance for credit loss should be established for debt securities by assessing pertinent facts and circumstances surrounding each security. Where the decline in fair value of debt securities is attributable to changes in market interest rates or to factors such as market volatility, liquidity and spread widening, and we anticipate recovery of all contractual or expected cash flows, we do not consider these investments to have credit loss because we do not intend to sell these investments and it is not more likely than not we will be required to sell these investments before a recovery of amortized cost, which may be maturity.

If we intend to sell a debt security or if it is more likely than not that we will be required to sell a debt security before recovery of its amortized cost basis, credit loss has occurred and the difference between amortized cost and fair value will be recognized as a loss in operations.

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If we do not intend to sell and it is not more likely than not we will be required to sell the debt security but also do not expect to recover the entire amortized cost basis of the security, a credit loss would be recognized in operations for the amount of the expected credit loss. We determine the amount of expected credit loss by calculating the present value of the cash flows expected to be collected discounted at each security's acquisition yield based on our consideration of whether the security was of high credit quality at the time of acquisition. The difference between the present value of expected future cash flows and the amortized cost basis of the security is the amount of credit loss recognized in operations. The recognized credit loss is limited to the total unrealized loss on the security (i.e., the fair value floor).

The determination of the credit loss component of a mortgage backed security is based on a number of factors. The primary consideration in this evaluation process is the issuer's ability to meet current and future interest and principal payments as contractually stated at time of purchase. Our review of these securities includes an analysis of the cash flow modeling under various default scenarios considering independent third party benchmarks, the seniority of the specific tranche within the structure of the security, the composition of the collateral and the actual default, loss severity and prepayment experience exhibited. With the input of third party assumptions for default projections, loss severity and prepayment expectations, we evaluate the cash flow projections to determine whether the security is performing in accordance with its contractual obligation.

We utilize models from a leading structured product software specialist serving institutional investors. These models incorporate each security's seniority and cash flow structure. In circumstances where the analysis implies a potential for principal loss at some point in the future, we use the "best estimate" cash flow projection discounted at the security's effective yield at acquisition to determine the amount of our potential credit loss associated with this security. The discounted expected future cash flows equates to our expected recovery value. Any shortfall of the expected recovery when compared to the amortized cost of the security will be recorded as credit loss.

The determination of the credit loss component of a corporate bond is based on the underlying financial performance of the issuer and their ability to meet their contractual obligations. Considerations in our evaluation include, but are not limited to, credit rating changes, financial statement and ratio analysis, changes in management, significant changes in credit spreads, breaches of financial covenants and a review of the economic outlook for the industry and markets in which they trade. In circumstances where an issuer appears unlikely to meet its future obligation, an estimate of credit loss is determined. Credit loss is calculated using default probabilities as derived from the credit default swaps markets in conjunction with recovery rates derived from independent third party analysis or a best estimate of credit loss. This credit loss rate is then incorporated into a present value calculation based on an expected principal loss in the future discounted at the yield at the date of purchase and compared to amortized cost to determine the amount of credit loss associated with the security.

We do not measure a credit loss allowance on accrued interest receivable as we write off any accrued interest receivable balance to net investment income in a timely manner when we have concerns regarding collectability.

Amounts on available for sale fixed maturities that are deemed to be uncollectible are written off and removed from the allowance for credit loss. A write-off may also occur if we intend to sell a security or when it is more likely than not we will be required to sell the security before the recovery of its amortized cost.

5. Derivative Instruments

None of our derivatives qualify for hedge accounting, thus, any change in the fair value of the derivatives is recognized immediately in the statements of operations. The fair value of our derivative instruments, including derivative instruments embedded in fixed index annuity contracts, presented in the balance sheet are as follows:

| | December 31, | |
|---|------------------------|-------------------|
| | 2022 | 2021 |
| | (Dollars in thousands) | |
| Liabilities | | |
| Policy benefit reserves - annuity products | | |
| Fixed index annuities - embedded derivatives | \$ 442,993 | \$ 651,146 |
| Funds withheld for reinsurance liabilities | | |
| Reinsurance related embedded derivative | 652,809 | — |
| | <u>\$ 1,095,802</u> | <u>\$ 651,146</u> |

The future index credits on the reinsured fixed index annuities are treated as a "series of embedded derivatives" over the expected life of the applicable contract. AEILIC does not purchase call options to fund the index liabilities which may arise after the next policy anniversary date. We must value both the call options and the related forward embedded options in the policies at fair value.

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Reinsurance agreements written on a funds withheld basis contain embedded derivatives. The right to receive the total return on the assets supporting the funds withheld represent a total return swap. The fair value of the embedded derivative on funds withheld agreements is computed as the unrealized gain (loss) on the underlying assets and will be included in the funds withheld asset on the balance sheet for assumed agreements.

6. Reinsurance

Effective December 31, 2021, we entered into a coinsurance funds withheld agreement with AEILIC, an affiliated life insurance company, to reinsure a closed block of fixed rate deferred and fixed indexed annuities. The effects of the reinsurance agreement are recorded as investment contracts. The following summarizes the agreement at inception:

| | Period Ended December 31, | |
|---------------------------|----------------------------------|-----------|
| | 2021 | |
| | (Dollars in thousands) | |
| Assets received | \$ | 4,285,065 |
| Less: Liabilities assumed | | 4,043,205 |
| Ceding commission paid | | 65,000 |
| Net cost of reinsurance | \$ | 176,860 |

The net cost of reinsurance is included within policy benefit reserves on the balance sheet and will be amortized over the life of the reinsurance agreement. The following table summarizes the reinsurance balances related to this agreement as of:

| | December 31, | |
|----------------------|-------------------------------|--------------|
| | 2022 | 2021 |
| | (Dollars in thousands) | |
| Assets | | |
| Funds withheld asset | \$ 3,254,668 | \$ 4,222,531 |
| Liabilities | | |
| Reinsurance payable | \$ 200,721 | \$ 9,924 |
| Cost of reinsurance | 157,288 | 176,860 |
| | \$ 358,009 | \$ 186,784 |

The following table summarizes the reinsurance balances related to this agreement for the period ended:

| | Period Ended December 31, | |
|---|----------------------------------|-------------|
| | 2022 | 2021 |
| | (Dollars in thousands) | |
| Investment income on funds withheld assets | \$ 163,607 | \$ — |
| Change in fair value of embedded derivatives on funds withheld assets | (673,285) | — |
| Deferred gain amortization | 20,139 | — |
| Ceding commission | 2,548 | — |
| | \$ (486,991) | \$ — |

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7. Income Taxes

Our income tax expense as presented in the state of operations consisted of the following:

| | <u>Year Ended December 31,</u> | <u>Period Ended December 31,</u> |
|--|--------------------------------|----------------------------------|
| | <u>2022</u> | <u>2021</u> |
| | (Dollars in thousands) | |
| Statements of operations: | | |
| Current income tax expense/(benefit) | \$ 259 | \$ — |
| Deferred income tax expense/(benefit) | (109,237) | (56) |
| Total income tax expense/(benefit) included in statement of operations | <u>\$ (108,978)</u> | <u>\$ (56)</u> |

Income tax expense in the statements of operations is equal to the applicable statutory federal income tax rate of 21% for the year ended December 31, 2022 and 2021.

Deferred income tax assets or liabilities are established for temporary differences between the financial reporting amounts and tax bases of assets and liabilities that will result in deductible or taxable amounts, respectively, in future years. The tax effects of temporary differences that give rise to the deferred tax assets and liabilities at December 31, 2022 and 2021, are as follows:

| | <u>December 31,</u> | |
|---|-------------------------------|-----------------|
| | <u>2022</u> | <u>2021</u> |
| | (Dollars in thousands) | |
| Deferred income tax assets: | | |
| Policy benefit reserves | \$ 19,543 | \$ 55,666 |
| Net unrealized losses on available for sale fixed maturity securities | 398 | — |
| Funds withheld reinsurance adjustments | 84,854 | — |
| Net operating loss carryforwards | 4,894 | 4,983 |
| Other | 103 | 54 |
| Gross deferred tax assets | <u>109,792</u> | <u>60,703</u> |
| Deferred income tax liabilities: | | |
| Investment income items | (79) | — |
| Funds withheld reinsurance adjustments | — | (50,360) |
| Other | (22) | (10,287) |
| Gross deferred tax liabilities | <u>(101)</u> | <u>(60,647)</u> |
| Net deferred income tax asset | <u>\$ 109,691</u> | <u>\$ 56</u> |

Realization of our deferred income tax assets is more likely than not based on expectations as to our future taxable income and considering all other available evidence, both positive and negative. Therefore, no valuation allowance against deferred income tax assets has been established as of December 31, 2022 and 2021.

There were no material income tax contingencies requiring recognition in our financial statements as of December 31, 2022. Our tax returns are subject to audit by various federal, state and local tax authorities. The Company's income tax returns are subject to examination by the IRS and state tax authorities, generally for three years after they are due or filed, whichever is later.

At December 31, 2022 and 2021, the Company has \$23.3 million and \$23.7 million, respectively, of net operating loss carryforwards for federal income tax purposes.

8. Notes Payable to Parent

On December 31, 2021, the Company entered into an intercompany credit facility agreement with the Holding Company. The agreement provided a credit facility of \$165.0 million which the Company could draw all or in part from time to time. The unpaid principal amounts, regardless of when advances are made, are due on December 31, 2026 or earlier at our request. Interest accrues daily at the secured overnight financing rate for such business day plus 150 bps. On December 31, 2021, the Company borrowed \$165.0 million under the credit facility agreement. The Company made \$79.3 million of principal payments on the loan during 2022, leaving \$85.7 million outstanding as of December 31, 2022. Interest expense on the borrowings was \$3.1 million for the year ended December 31, 2022.

AEL Re Bermuda Ltd.

Notes to Financial Statements

December 31, 2022

9. Commitments and Contingencies

The Company may be from time to time subject to legal proceedings and claims in the ordinary course of business. In accordance with applicable accounting guidelines, we establish an accrued liability for litigation and regulatory matters when those matters present loss contingencies that are both probable and estimable. As a litigation or regulatory matter is developing we, in conjunction with outside counsel, evaluate on an ongoing basis whether the matter presents a loss contingency that meets conditions indicating the need for accrual and/or disclosure, and if not, the matter will continue to be monitored for further developments. If and when the loss contingency related to litigation or regulatory matters is deemed to be both probable and estimable, we will establish an accrued liability with respect to that matter and will continue to monitor the matter for further developments that may affect the amount of the accrued liability.

There can be no assurance that any pending or future litigation will not have a material adverse effect on our business, financial condition, or results of operations.

10. Related Party Transactions

The Company has an Investment Advisory Agreement with the Holding Company. Under this agreement, the Company pays a quarterly fee in arrears based on an annual rate of 0.25% on the first \$100 million plus 0.20% on the amount in excess of \$100 million of the fair value of the average quarterly net asset value. As the Company commenced operations on December 31, 2021, no fees were incurred under this agreement in 2021. There were \$8.2 million of fees incurred under this agreement during 2022.

The Company has a Management Services Agreement with the Holding Company and its subsidiaries. Under this agreement, certain services may be performed by Holding Company subsidiaries on behalf of AEL Re Bermuda. The services included in the Management Services Agreement include general, administrative, and other services including support services, treasury services, tax services, legal affairs, accounting/books and records, financial statements/periodic reports, financial services, property management, borrowing documentation, government approvals, investor relations, human resources, strategic planning and business development, corporate finance services, record services, procurement, travel related services, and use of office space, technical services, and intellectual property and licenses. In exchange for providing these functions, the Company reimburses AEILIC for costs as calculated in accordance with the Management Services Agreement.

The Company incurred expenses of \$10.2 million and \$0.1 million related to this agreement during the period ended December 31, 2022 and 2021, respectively. As of December 31, 2022 and 2021, the Company owed AEILIC \$26 thousand and \$144 thousand, respectively, related to the expenses incurred in 2022 and 2021 on its behalf.

As of December 31, 2022 and 2021, the Company owed AEILIC \$202,103 thousand and \$9,924 thousand, respectively, related to the reinsurance agreement with AEILIC.

11. Common Shares

The Company has one class of common stock which represents 100% of the Company's total voting shares. All issued shares are beneficially owned by the Holding Company.

12. Statutory Requirements

The Company is licensed by the Bermuda Monetary Authority ("BMA") as a Class C insurer and is subject to the Insurance Act 1978, as amended ("Bermuda Insurance Act") and regulations promulgated thereunder. The BMA implemented the Economic Balance Sheet ("EBS") framework into the Bermuda Solvency and Capital Requirement ("BSCR") which was granted equivalency to the European Union's Directive (2009/138/EC) ("Solvency II"). Under this framework a Class C insurer must produce three sets of financial statements

- GAAP Financial Statements – Financial statements prepared in accordance with an internationally recognized comprehensive basis of accounting. We have elected to prepare US GAAP Financial statements. These financial statements form the basis for the Statutory Financial Statements and the Economic Balance Sheet.
- Statutory Financial Statements (SFS) – Equal to the US GAAP financial statements adjusted to eliminate non-admitted assets including goodwill and other similar intangible assets not considered admissible for solvency purposes, and certain assets and liabilities that are generally off-balance sheet under general purpose reporting. These include items such as guarantees and other instruments that do not relate to the insurer's own insurance contracts. The SFS is also adjusted based upon directions or permitted practices issued by the BMA.
- Economic Balance Sheet (EBS) – A balance sheet where assets are recorded based on US GAAP fair values and insurance reserves are based on technical provisions comprised of a best estimate liability plus a risk margin. The best estimate liability may be calculated by applying the standard approach or the scenario approach.

AEL Re Bermuda Ltd.

Notes to Financial Statements

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Based upon the Bermuda Insurance Act, the Company is required to maintain minimum statutory capital and surplus to meet the minimum margin of solvency ("MMS") and minimum economic statutory capital and surplus (EBS capital and surplus) to meet the Enhanced Capital Requirement ("ECR"). The MMS is equal to the greater of \$500,000 or 1.5% of total statutory assets. The ECR is calculated using the risk-based capital model where risk factor charges are applied to the EBS. As of December 31, 2022 and 2021 the Company met the minimum requirements.

For the SFS, we received the following permitted practices from the BMA:

- We are permitted to remove the effect of the Financial Accounting Standard 133 DIG Issue B36 ("DIG B36") which creates an embedded derivative on the funds withheld assets;
- We are permitted to record fixed income securities at amortized cost and therefore not recognize unrealized gains and/or losses on those investments; and
- We are permitted to calculate reserves on assumed fixed index annuity contracts based on policyholder account values.

The following represents the effect of the permitted practices to the statutory financial statements:

| | Year Ended December 31, | Period Ended December 31, |
|--|--------------------------------|----------------------------------|
| | 2022 | 2021 |
| | (Dollars in thousands) | |
| Increase (decrease) to capital and surplus due to permitted practices | \$ 431,617 | \$ — |
| Increase (decrease) to statutory net income due to permitted practices | 430,119 | — |

The Company cannot pay dividends:

1. Which exceed 25% of our total statutory capital and surplus in our prior year SFS unless at least seven days before payment of the dividend we file with the Authority an affidavit signed: a) by at least two directors (one of whom must be a director resident in Bermuda), and b) by the Company's principal representative in Bermuda which states that in the opinion of those signing, declaration of those dividends has not caused the Company to fail to meet its relevant margins. A copy of every affidavit filed shall be kept by the Authority in its office and shall be open to the inspection by the public.
2. During any financial year if it would cause the Company to fail to meet its relevant margins.
3. If the Company fails to meet the relevant margins on the last day of any financial year, without the approval of the authority during the next year.

13. Subsequent Events

The Company has evaluated subsequent events through April 13, 2023, which is the date the financial statements were available to be issued.